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C O N F I D E N T I A L SECTION 01 OF 04 QUITO 001340

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SUBJECT: GUTIERREZ RETURN JUST ONE OF PALACIO'S PROBLEMS

Classified By: Ambassador Kristie A. Kenney, Reasons 1.4 (b), (d)

1. (C) SUMMARY: Forty-five days young, the Alfredo Palacio government has hit its first snags. Two cabinet ministers resigned this week (Septel) amidst charges they owed money to the state. One other is backpedaling over accusations he conspired to depose former President Lucio Gutierrez. Military officers, convenient whipping-boys of late, are growing frustrated over "inept" civilian government. Despite the oil boom, GoE finances are questionable, and Palacio's anti-establishment finance minister has spooked international financial institutions (IFIs) capable of bridging gaps. Quito's "forajidos" -- middle-class protesters who helped force Gutierrez to flee -- have grown disillusioned over the slow pace of political reform. And Amazon provinces are threatening general strikes over alleged GoE inattention.

2. (C) Mix in rumors of Gutierrez's reappearance and voila, political instability returns to Ecuador. Capitalizing on Palacio's current troubles, the ex-president has announced he's coming home, aiming to resume his battle against the nation's political and economic oligarchy. Gutierrez might face lynching in Quito, but his allies are many in Tena, his Amazon birthplace. A final destabilizer is Palacio's seeming lack of fortitude, confirmed by his wife. Our best prediction? The president looks secure through summer, but the looming budget shortfall might make for an awful autumn. END SUMMARY.

Problems of his own making...

3. (SBU) "Debtor-gate" broke three weeks ago when Quito daily El Comercio reported that Minister of Energy Fausto Cordovez had been delinquent in repaying over \$100,000 in state debt (the octogenarian minister opportunistically paid his bill shortly after the reporter solicited comment). The scandal has had legs, however, with updated debtor lists appearing daily and editorialists questioning the administration's lack of due diligence over nominations. Presidential Communications Director Carlos Cortez fell first, submitting his resignation June 7; Cordovez followed a day later, and media June 9 reported the departure of Roberto Pinzon, president of parastatal oil company PetroEcuador. Ultrationalist gringo-basher Mauricio Gandara too appears on the list, as does FM Antonio Parra.

4. (SBU) Smelling blood, opposition figures, among them ex-presidential brother Gilmar Gutierrez, have demanded Palacio purge all deadbeats from the government. More troublesome to the government, NGOs and citizen watchdog groups have seconded the demand. The administration responded by forming a commission, led by Administration General Secretary Luis Herreria and Legal Subsecretary Roberto Gonzalez, to investigate. The "accused" have screamed that a witchhunt is afoot.

5. (C) Gandara, long a thorn in our foot, has begun to bring problems to his boss as well. In June 6 public comments, the diminutive but boisterous minister revealed that Palacio, even before he assumed the presidency April 20, had requested Gandara's collaboration in the eventual administration. Media noted he had filed his "statement of assets," a requirement for those assuming high government office, before Gutierrez abandoned Carondelet Palace. Opposition cried foul in response, calling the current government minister a conspirator and citing as further proof Gandara's admission he'd earlier lobbied Gutierrez's high command to withdraw their support to the then-president. Believing the best defense a good offense, Gandara is screaming "conspiracy" himself, claiming Gutierrez allies are attempting to depose Palacio by disparaging his economic team's policies and practices, torpedoing international investors' confidence in Ecuador. Police commander General Jose Vinueza confided to the Ambassador that Palacio is livid over Gandara's revelations.

Added to external factors...

6. (SBU) "Strained" describes relations between the new president and the military, dating back to Palacio's assumption of power April 20. After taking the oath of

office in Quito think-tank CIESPAL, a crowd of violent protesters laid siege to the facility. For four hours Palacio hunkered down while public forces, capable of rescuing him, allegedly loitered about. Early scuttlebutt (later disproved) claimed it was police, not army, who eventually freed the president. Palacio purged the armed forces high command days later, and a common headline since has been "Where Was the Military." Media also alleged an April 22 plot by commanders of nearby units to depose the president; Defense Minister Solon Espinoza investigated and later cleared the officers, however.

17. (C) Nonetheless, morale within the armed forces remains questionable. Congress and media, demanding the military not involve itself in civilian affairs, are debating changes to Ecuador's constitution and organic armed forces law. Concurrently, talking heads like retired Colonel Luis Herrera argue the army only takes such stances upon orders from civilian bosses. In private conversations with DAO and Milgroup personnel, Ecuadorian officers lament the current state of affairs, asserting the country would benefit from benevolent military rule. Summer sees promotion boards assembling; up for stars are numerous colonels hailing from Gutierrez's year group and seen as sympathetic to the former president. Were the promotion rate to fall significantly below norms, the potential for protest is real.

18. (C) Three years of record oil prices have swelled government coffers, despite declining PetroEcuador production. Regrettably, steadily rising salary outlays have meant the budget numbers aren't black. Media report daily the GoE's needs for hundreds of millions in bridge financing to cover expected fiscal gaps. Yet Palacio's economic team is offering the IFIs vinegar, not honey. Economy Minister Rafael Correa's populist schlock -- "pay the social debt, not the foreign debt" -- has won him numerous admirers; as perhaps this administration's most popular minister, he enjoys the president's ear. Such vitriol makes him unpopular in World Bank, IDB, and IMF circles, however. Former Gutierrez Finance Minister Mauricio Yopez informed the Ambassador that, without external assistance, Ecuador would run out of cash in October.

The "street's" discontent...

19. (C) Palacio came to power boasting he was Ecuador's last, best hope. Quito's forajidos demanded and deserved better governance; he would make their dreams reality. Topping the protesters' wishlist was a more direct democracy less beholden to party strongmen, featuring a cleansed Congress and depoliticized courts. Tactics envisioned included referenda, popular assemblies, and a constitutional rework. Forty-five days later, however, little has changed. Congress removed 15 deputies, but most viewed the move as political retribution, not good-faith reform. Palacio tapped Vice President Alejandro Serrano to facilitate a national political dialogue, but the VP told the Ambassador June 3 the details remained fuzzy. The widely hailed "Consulta Popular" (referendum) on political and constitutional reform will not occur until December, since the administration needs time to synthesize dialogue results and formulate consulta questions. And Ecuador has yet to re-establish the Supreme Court, the result of expected political bickering.

110. (C) Quito remain calm for now. Yet renewed protests appear possible, especially if continued corruption scandals amongst ministers, Congressional do-nothingness, and a re-politicized court lead forajidos to believe Palacio is a business-as-usual chief executive.

11. (U) One hundred miles east, streets aren't so calm. Protesting against the newly named governor of Napo province, Gutierrez sympathizers June 6 burned vehicles and trashed government offices in capital Tena. In fellow Amazon provinces Orellana and Sucumbios, the heart of Ecuador's oil industry, leaders have called for a June 21 general strike to protest Palacio's inattention to their needs (the president earlier had declared a state of emergency in these provinces in response to citizens' threats to take over key petroleum infrastructure; Congress voted June 8 to revoke the special measure). Pro-government parties in Congress publicly announced their worries that Gutierrez allies would seek political benefit from the public's discontent.

An ex-leader's rumored return...

112. (SBU) Ecuador's exiled ex-presidents have assumed one of two postures. Jamil Mahuad (2000) and Gustavo Noboa (2003) adopted low profiles in Boston and the Dominican Republic, refraining from political activity, while Abdala Bucaram (1997) continued to run his PRE party from Panama. Lucio Gutierrez has fallen into the latter camp. Media and

opposition greeted with consternation the ex-president's June 5 decision to abandon asylee status in Brazil. News of his travel to the United States spiked interest further, especially after press erroneously reported he would address the OAS and offer "his side of the story" to USG officials. The story peaked (or perhaps not) with the June 8 distribution of a video in which Gutierrez outlined reasons the oligarchy had deposed him.

¶13. (U) "I was collecting debts from those who had bankrupted the country. I was breaking the elite's hold over the Ecuadorian judiciary. And I was becoming a threat to the oligarchy, for my efforts to help Ecuador's poor." Further, he claimed the forajidos who attempted to prevent his departure had aimed to kill him. Gutierrez confidant and former Administration Secretary Fausto Cobo announced that the ex-president's priority was returning to Ecuador soonest, although he offered no dates.

¶14. (SBU) Pro-government/anti-Gutierrez forces aren't lying down, and the ex-president likely will face a lynch mob should he choose to return to Quito soon. In Congress, for example, the Investigative Commission is gathering information on alleged Gutierrez campaign violations in hopes of jump-starting an eventual prosecution. Pachakutik deputies seek charges against the former president for complicity in the death of a Chilean forajido. And Popular Democracy Congressman Ramiro Rivera is introducing a bill aimed at preventing Gutierrez from seeking re-election.

And the President's aversion to battle...

¶15. (C) Save a short stint as health minister during the Sixto Duran-Ballen administration (1993-97), heart surgeon and now President Palacio had no political experience before signing on with Gutierrez in 2002. While he obviously relishes the presidency's limelight and accouterments, we're not so certain he enjoys the accompanying back room dealmaking and political bloodshed. First Lady Maria Beatriz de Palacio confirmed our suspicions over breakfast with the Ambassador June 7. "What was Alfredo doing, taking this job? These people are crazy!" The First Lady was referring to the scores of job seekers walking Carondelet halls of late, but it might as well have been a description of the Ecuadorian political scene. There would be no re-election campaign, if she had her way -- eighteen months in Quito were plenty. The First Lady revealed that Dr. Palacio recently had passed two of three parts of the Florida medical licensing process, raising his employment possibilities considerably.

Leaves this president weak and growing weaker

¶16. (C) COMMENT: "Muddling through" long has described presidential administrations in Ecuador. Palacio likely will follow his predecessors' paths, dealing here, bribing there, all in hopes of short-term survival. Of the destabilizers mentioned above, nearly all look surmountable. A Cabinet shuffle should stem protests on the debtors and conspirators issues, for example. A salary bump should squelch military discontent. Amazonians would build statues to Palacio in exchange for highways and bridges. A well-organized national dialogue and invitations to prominent youth leaders to join the government ought calm the forajidos. And even a Gutierrez return looks benign, since only native Tena would seem to welcome him.

¶17. (C) We wrote "nearly" all, however. The looming financial crisis appears the silver bullet that could bring Palacio down, as earlier ones did Mahuad and Bucaram. Yet the president's damage control team overlooks this, focusing instead on crises du jour like Gutierrez. In upcoming meetings with saner administration officials (read, not Gandara and Correa), we will push for constructive IFI engagement and sustainable administration economic and fiscal policies. Should we have no luck, come November or December the forajidos might again take to the streets. END COMMENT. Kenney